# Myths and Realities about Swipe Fee Reform

In 2010, Congress enacted interchange fee (a.k.a. "swipe fee") reform legislation in order to bring transparency, competition and choice to a debit card system that had been rigged by the Visa-MasterCard duopoly and big banks like Wells Fargo. This reform law, codified at 15 USC §1693o-2 and known as the Durbin Amendment, contained two main parts. The first part directed the Federal Reserve Board to place reasonable constraints on the interchange fee price-fixing that card networks like Visa and MasterCard conduct on behalf of large debit card-issuing banks. The second part rescinded several anti-competitive restrictions that card networks had imposed on other participants in the debit system. A summary of the law is included at the end of this document. The financial industry and card companies are currently lobbying to repeal this law and to take the debit card system back to the anticompetitive pre-2010 system. In their advocacy, the big banks and card networks have put forward a number of myths about the Durbin Amendment that are debunked below.

**Myth #1: The Durbin Amendment introduced price-fixing into what was previously a competitive marketplace.**

**Reality: The Durbin Amendment placed reasonable limits on price-fixing that was already occurring in the debit system, and it gave banks incentives to set their own prices rather than use fees fixed by Visa and MasterCard.**

Normally when banks charge fees, each bank sets its own fee and they compete with one another to win business. This competition helps keep fee rates down and incentivizes greater efficiency. But for years, card-issuing banks and credit unions had agreed to let the Visa and MasterCard networks price-fix the interchange amounts that all issuers in those networks charged merchants each time a debit card is swiped. This centralized fee-fixing avoided competition, kept prices high and diminished the issuers' incentive to manage their operational and fraud costs efficiently (because all issuers were guaranteed the same set of network-fixed interchange fees regardless of the efficiency and security of their card operations). Even more troubling, Visa and MasterCard had incentive to constantly increase interchange fees in order to encourage issuers to issue more cards with their network logo. Given the collective market power of all of the banks and credit unions agreeing to fixed fees, there was no countervailing market force that enabled those who accepted debit cards as payment (merchants, universities, charities, government agencies, etc.) to temper those fee increases. The result was ever-rising debit interchange fees that subsidized bank inefficiencies, and the billions charged annually through these fees were ultimately borne by consumers in the form of higher retail prices. In short, the system was rigged.

The Durbin Amendment reformed this rigged system in a careful way, providing that if a card issuer with assets of over $10 billion lets a card network fix debit swipe fees on its behalf, then the Federal Reserve must ensure that those swipe fees are reasonable and proportional to the cost of processing the transaction. The Durbin Amendment actually discourages price fixing, because if a bank simply competes by setting its own swipe fee rates, those rates are not regulated by the Durbin Amendment and the banks can charge as much as the market will bear. Only those swipe fees that big banks let a card network fix on their behalf are regulated.

**Myth #2:** **The Durbin Amendment was inserted into Dodd-Frank in the dead of night and at the 11th hour.**

**Reality:** **The Durbin Amendment was adopted on the Senate floor by a bipartisan vote of 64-33 on May 13, 2010. It was maintained in conference committee with the House of Representatives and signed into law as part of Dodd-Frank on July 21, 2010.**

**Myth # 3:** **There was no Congressional analysis or consideration of swipe fee reform prior to passage of the Durbin Amendment.**

**Reality:** **The Durbin Amendment passed after years of Congressional hearings,[1] Government Accountability Office reports,[2] Federal Reserve studies,[3] academic articles,[4] and press reports[5] that demonstrated that the interchange or swipe fee system was not a properly functioning market.**

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[1] *See, e.g., Hearing on the Law and Economics of Interchange Fees, Before the Subcommittee on Commerce, Trade, and Consumer Protection, H. Comm. on Energy and Commerce,* 109th Cong. (2006); *Hearing on Credit Card Interchange Rates: Antitrust Concerns? Before the S. Comm. on the Judiciary*, 109th Cong. (2006); *Hearing on Credit Card Interchange Fees Before the Antitrust Task Force, H. Comm. on the Judiciary*, 110th Cong. (2007); *Hearing on H.R. 5546, the Credit Card Fair Fee Act, Before the Antitrust Task Force, H. Comm. on the Judiciary*, 109th Cong. (2008); *Hearing on H.R. 2382, the Credit Card Interchange Fees Act of 2009 Before the H. Comm. on Financial Services*, 111th Cong. (2009); *Hearing on H.R. 2695, the Credit Card Fair Fee Act of 2009 Before the H. Comm. on the Judiciary*, 111th Cong. (2010); *Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars, Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 111th Cong. (2010).

[2] *See, e.g.,* U.S. Gov't Accountability Office, *Credit and Debit Cards: Federal Entities Are Taking Actions to Limit Their Interchange Fees, but Additional Revenue Collection Cost Savings May Exist*, GAO-08-558 (May 2008); U.S. Gov't Accountability Office, *Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO-10-45 (Nov. 2009).

[3] *See, e.g.,* Terri Bradford & Fumiko Hayashi, *Developments in Interchange Fees in the United States and Abroad*, Federal Reserve Bank of Kansas City, Apr. 2008, *available at* http://www.kansascityfed.org/Publicat/PSR/Briefings/PSR-BriefingApr08.pdf (stating that "While regulation of interchange fees is still just a point of discussion in the United States, regulation abroad is a reality. In about 20 countries, public authorities have taken actions that limit the level of interchange fees or merchant discount fees. Many of these actions require interchange fees to be set according to cost-based benchmarks, although the cost categories that are eligible for the benchmarks vary by country. In several countries, interchange fees are set at zero."); Robin A. Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues*, Federal Reserve Board Division of Research & Statistics and Monetary Affairs, Finance and Economics Discussion Series, 2009-23, *available at* http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf (analyzing the structure and economic theory behind the interchange system and discussing various proposals for reform); James McAndrews & Zhu Wang, *The Economics of Two-Sided Payment Card Markets: Pricing, Adoption and Usage*, Federal Reserve Bank of Kansas City, Dec. 2008, http://www.kansascityfed.org/Publicat/RESWKPAP/PDF/RWP08-12.pdf (stating that "privately determined card pricing, adoption and usage tend to deviate from the social optimum, and imposing a ceiling on interchange fees may improve consumer welfare.").

[4] *See, e.g.,* Fumiko Hayashi, *Payment Card Interchange Fees and Merchant Service Charges – An International Comparison*, Lydian Payments Journal, Jan. 2010, at 6, 11-12, *available at* http://www.pymnts.com/business-wire/2010/payment-card-interchange-fees-and-merchant-service-charges-an-international-comparison/ (finding that "[i]n general, the United States has the highest debit card interchange fees" and that "the United States has the highest interchange fees for both credit and debit cards among the 13 countries where adoption and usage of payment cards are well advanced."); Alan S. Frankel & Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627, 671 (2006) (finding that the interchange fee "acts much like a sales tax, but it is privately imposed and collected by banks, not the government. It significantly and arbitrarily raises prices based not

These analyses showed that the swipe fee system was designed and operated by Visa, MasterCard and their card-issuing banks to avoid competition and to generate high fees that exceeded what could be sustained in a normal competitive market environment. Bipartisan legislation that sought to create a fair process for merchants to negotiate both credit and debit swipe fees with Visa and MasterCard passed out of the House Judiciary Committee in 2008 with the support of a majority of Committee Republicans including then-Representative Mike Pence. Swipe fee reform was debated again during Senate consideration of the 2009 Credit CARD Act when Senators Durbin and Bond tried to offer a modest bipartisan amendment that tried to promote fee transparency and better discounting options for merchants. The reality is that the need for swipe fee reform has been clear for over a decade, but the financial industry and card networks have always opposed meaningful reform.

**Myth #4** **It is unprecedented for the government to regulate the fees charged for debiting money from checking accounts.**

**Reality:** **There is ample precedent both in the United States and around the world for government oversight and intervention to limit banks from deducting excessive fees when money is debited from checking accounts.**

The Federal Reserve Act of 1913 required that checks in the Federal Reserve banking system clear at par, meaning that no fees could be deducted as the money passed between banks.[6] Internationally, numerous countries have regulated the swipe fee system through legislation or action by central banks or competition authorities. This document from researchers at the Kansas City Fed discusses swipe fee regulatory reforms in 32 foreign countries plus the European Union (which in 2015 capped both debit and credit swipe fee rates), and the chart on page 5 of this Kansas City Fed analysis shows that debit interchange fees continue to be higher in the U.S. than in other countries that have taken more robust action to bring the fee levels under control.

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on technologically and competitively determined costs, but through a collective process."); Dennis W. Carlton, *Externalities in Payment Card Networks: Theories and Evidence, Commentary*, The Changing Retail Payments Landscape: What Role for Central Banks, proceedings of a conference held at the Federal Reserve Bank of Kansas City, Nov. 9-10, 2009 at 125, 129, *available at* https://www.kansascityfed.org/publicat/pscp/2009/PDF/Carlton.pdf (finding that "in seven of the eight countries with the highest debit card usage per capita there is no interchange fee.").

[5] *See, e.g.,* Andrew Martin, *How Visa, Using Card Fees, Dominates a Market*, N.Y. Times, Jan. 4, 2010. ("Competition, of course, usually forces prices lower. But for payment networks like Visa and MasterCard, competition in the card business is more about winning over banks that actually issue the cards than consumers who use them. Visa and MasterCard set the fees that merchants must pay the cardholder's bank. And higher fees mean higher profits for banks, even if it means that merchants shift the cost to consumers."), *available at* http://www.nytimes.com/2010/01/05/your-money/credit-and-debit-cards/05visa.html?pagewanted=all.

[6] *See* 12 USC 360, created by 38 Stat. 265, Dec. 23, 1913, ch. 6, §16 (par.).

**Myth #5:** **The Durbin Amendment has made it difficult for banks and credit unions to cover the cost of offering debit cards.**

**Reality:** **Swipe fees are still lucrative for card issuers under the Durbin Amendment.**

On November 30, the Federal Reserve released its most recent biannual report on interchange fees and debit costs, summarizing data from 2015. The report revealed the following:

- Card issuing banks and credit unions received $18.41 billion in debit interchange fees in 2015.
- Debit interchange fees are still lucrative for big banks that are subject to the Fed's regulation. For debit card issuers with assets of over $10 billion that are subject to the Fed's regulator limit on debit interchange fees, the average cost per transaction of conducting a debit transaction is just 4.2 cents.
- Debit interchange fees are even more lucrative for small banks and credit unions that are not subject to the Fed's regulation. The Fed reported that the average debit interchange fee for non-regulated debit card issuers is 43 cents per transaction, nearly double the average fee for regulated issuers.

The continued profitability of debit transactions for card issuers is evidenced by the continued robust growth in debit card use. According to the Federal Reserve, "debit card payments grew at an annual rate of 7.1 percent by number or 6.8 percent by value from 2012 to 2015."[7]

**Myth #6:** **The Durbin Amendment reduced free checking for consumers.**

**Reality:** **According to the banking industry's own statistics, free checking has become more widely available since the Durbin Amendment.**

The banking industry routinely argues that the Durbin Amendment forced banks that were subject to swipe fee regulation to increase checking account fees on consumers to make up for the lost fee revenue. But the American Bankers Association's own statistics show that free checking is still widely available to consumers. In fact, the ABA reported in 2015 that "the majority of Americans--61 percent--pay nothing at all for bank services"--an increase from the 53 percent the ABA reported had free checking when the legislation passed in 2010.[8]

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[7] The Federal Reserve Payments Study 2016, p. 2, *available at* https://www.federalreserve.gov/newsevents/press/other/2016-payments-study-20161222.pdf.

[8] *See* American Bankers Association, "Survey: Most Americans Pay Nothing for Bank Services," August 18, 2015, *available at* http://www.aba.com/Press/Pages/081815SurveyonBankCosts.aspx; *see also* American Bankers Association, "ABA Survey Shows Majority of Bank Customers Pay Nothing for Monthly Bank Services," Oct. 7, 2010, *available at* http://www.prnewswire.com/news-releases/aba-survey-shows-majority-of-bank-customers-pay-nothing-for-monthly-bank-services-104516904.html.

**Myth #7:** **The Durbin Amendment has forced banks to raise other consumer checking account fees to make up for lost revenue.**

**Reality:** **As noted above, free checking has increased under Durbin, which is remarkable since banks consistently try to increase consumer fees as much as the competitive and regulatory environment will allow them.**

Banks have routinely sought to increase fees on consumers. They certainly were not shy about raising consumer fees prior to the enactment of the Durbin Amendment in July 2010, as these stories demonstrate:

- November 12, 2008 - "Banks Boost Customer Fees to Record Highs" - Wall Street Journal
- May 28, 2009 - "Banks Find Ways To Boost Fees; Checking Accounts Latest Target" – ABC News
- July 1, 2009 - "Bank Fees Rise as Lenders Try to Offset Losses" - New York Times
- July 17, 2009 - "Why Are Banks Raising Fees?" – CBS News
- January 4, 2010 - "Banks Eye New Fees, Revenue in 2010" - ConsumerAffairs.com
- May 18, 2010 - "Banks return to charging credit card, checking account fees" - USA Today
- June 21, 2010 - "Wells Fargo to boost checking fees" - Business Journal

Banks may have changed their justifications over the years for why they raise consumer fees -- from the financial crisis to loan losses to overdraft regulations to swipe fee reform-- but they have consistently increased consumer fees as far as the market and the regulatory environment will allow. Reasonable regulation is needed to ensure competitive markets for the fees banks take from consumers as well as for the fees they take from merchants.

**Myth #8:** **Small banks and credit unions have been hurt by swipe fee reform.**

**Reality:** **The Durbin Amendment gives small banks and credit unions a significant competitive advantage over big banks.**

The Durbin Amendment allows small banks and credit unions to continue to price-fix debit swipe fee rates without limitation, and as a result, those institutions currently receive significantly higher debit swipe fee rates than their big bank competitors. This is a boon to small banks and credit unions, which they have used to win business away from the big banks. In fact, the Philadelphia Fed studied this question in 2016 and found that interchange revenue "continued rising for small banks" after reform.[9]

The Federal Reserve reported in November 2016 that the average swipe fee for small banks and credit unions is 43 cents per transaction, nearly double the

[9] James DiSalvo and Ryan Johnston, *How Dodd-Frank Affects Small Bank Costs,* Federal Reserve Bank of Philadelphia Research Department, First Quarter 2016, at 17.

regulated fee rate for big banks. This reflects a significant competitive advantage that small banks and credit unions receive over big banks under the current system. In fact, the Fed reported that small banks and credit unions received 52% of total debit swipe fee revenue in 2015 ($9.59 billion) even though they conducted only 35% of the total number of debit transactions.

The trade associations representing small banks and credit unions, such as ICBA and NAFCU, often criticize the Durbin Amendment. However, ICBA and NAFCU typically fail to disclose that they have for-profit subsidiaries that have debit partnerships with Visa and MasterCard.[10]

**Myth #9:** **Debit rewards programs have disappeared under the Durbin Amendment.**

**Reality:** **Not according to the financial industry's own publications.**

In March 2016 the trade industry publication CU Today reported that "Debit card reward programs, once considered a dying breed as the Durbin rules took hold, are still going strong at many of the nation's largest financial institutions, a new study shows. According to a new report from the Mercator Advisory Group, a majority of the country's top banks and credit unions offer debit card reward programs: 14 of the 25 largest banks and 13 of the 25 largest credit unions."[11] And the Credit Union Times reported that "53% of credit unions say they're likely to add a debit rewards program in the next 12 months, according to a survey conducted by CUNA Strategic Services and Buzz Points."[12]

**Myth #10:** **The Durbin Amendment's non-exclusivity and routing provisions have burdened small banks and credit unions.**

**Reality:** **These provisions have fostered increased competition, innovation and choice in the debit network market to the benefit of all stakeholders. Prior to reform, Visa and MasterCard paid to ensure that their competitors (smaller networks like Star, Pulse, NYCE, Shazam and others) were blocked from cards and unable to compete for transactions.**

The Durbin Amendment directed the Federal Reserve to issue regulations ensuring that banks and card networks cannot limit a debit card to only be allowed to be run exclusively on one debit network. The intent behind this provision was to stop the pay-offs that blocked smaller networks from having a chance to compete.

In the early years of the debit card system, banks routinely issued debit cards that bore the logos of and could be transacted upon multiple debit networks. But leading up to 2010, the largest debit networks began requiring issuers to sign

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[10] *See* http://www.icba.org/bancard and http://newsroom.mastercard.com/press-releases/nafcu-announces-partnership-mastercard-support-credit-unions-innovative-credit-debit-prepaid-branded-solutions/.

[11] "Despite Durbin, Debit Card Reward Programs Remain Vibrant," CU Today, March 29, 2016, at http://www.cutoday.info/Fresh-Today/Despite-Durbin-Debit-Card-Reward-Programs-Remain-Vibrant.

[12] Tina Orem, "Credit Unions Pile into Debit Rewards," *Credit Union Times*, Jan. 20, 2016, at http://www.cutimes.com/2016/01/20/credit-unions-pile-into-debit-rewards?page=2&slreturn=1486526918.

exclusivity agreements under which their network would become the exclusive network on the issuers' cards. Basically, Visa and MasterCard had gotten in the anticompetitive habit of paying incentives to banks to block other debit card networks from handling the banks' debit transactions. The American Banker newspaper reported in 2010 that "about 40% to 50% of the debit card market in the U.S. is under exclusive routing arrangements."[13] This trend toward exclusivity agreements, particularly when utilized by dominant networks such as Visa and MasterCard, was troubling in three ways: it limited merchant and consumer choice; it diminished competition by threatening to drive competing debit networks out of business; and it created significant barriers to entry for new debit networks.

The Durbin Amendment preserved competition and enhanced choice by directing the Fed to issue regulations ensuring that card networks and issuers cannot directly or indirectly limit a debit card to only be allowed to run on one exclusive network, and cannot dictate which of those networks a transaction must be routed over. These non-exclusivity and routing provisions have fostered increased competition and innovation in the debit network market. According to one study, "PIN-debit networks like Star, NYCE, Shazam, and Pulse collectively enjoyed an average annual transaction growth rate of 24% between 2010 and 2013, from 5 billion to 9.5 billion. And they saw their share of PIN traffic soar from just under one-third to slightly more than half."[14]

Repealing the Durbin Amendment would likely be the death knell for smaller debit networks that are trying to compete with Visa and MasterCard, and it would create a nearly insurmountable barrier to entry for new market competitors in the debit system. Lack of choice in debit network options does not serve small card issuers well. If the debit network market shrinks to only include Visa and MasterCard, those dominant networks would have incentive to partner with their largest bank issuers on more favorable terms than the terms made available to smaller issuers (as Visa and JP Morgan Chase have already done[15]).

**Myth #11: The Durbin Amendment has made it harder for card issuers to prevent fraud.**

**Reality: The Durbin Amendment attempts to correct banks' incentive to steer customers towards the highest fee transactions rather than the most fraud-proof transactions.**

Among its provisions, the Durbin Amendment sought to realign the incentives regarding fraud prevention in the debit card system. The interchange system had

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[13] *See* Andrew Johnson, "Fed's Plan Raises Debit Issues Galore," American Banker, December 20, 2010, at http://www.americanbanker.com/bulletins/debit-issues-galore-1030247-1.html.

[14] *See* "The Great PIN-Debit 'Claw-Back,'" Digital Transaction, June 1, 2015, *available at* http://www.digitaltransactions.net/news/story/The-Great-PIN-Debit-_Claw-Back_.

[15] *See* Andrew R. Johnson and Matthias Reiker, "J.P. Morgan to Offer Deals in Visa Partnership," *The Wall Street Journal*, Feb. 26, 2013, at https://www.wsj.com/articles/SB10001424127887324338604578328352611255658 ("J.P. Morgan Chase & Co. will offer discounts and other deals to its cardholders at the check-out counter through a partnership with Visa Inc. in a bid to capture more business from merchants and consumers.").

disincentivized card issuers from investing in fraud prevention in two ways: (1) all issuing banks in a network received the same amount of interchange fees regardless of how much fraud occurred with an issuer's cards; and (2) networks set higher interchange rates for more fraud-prone types of card transactions, which prompted issuers to steer their cardholders toward less-secure payment methods in order to collect more fees.[16] Prior to the Durbin Amendment, banks often refused to promote fraud prevention measures like PINs, preferring instead to steer consumers toward less secure signature debit transactions which carried higher interchange fees.[17] But the Durbin Amendment directed the Fed to allow issuers to receive an upward adjustment in interchange fees if, and only if, the issuers take effective steps to reduce fraud. Mere weeks after a 2011 Senate vote to delay the Durbin Amendment failed and the Fed announced its rulemaking, Visa announced a roadmap to promote U.S. adoption of EMV chip-card fraud prevention technology (a security technology already in use by nearly all other developed countries).[18] However, the Visa roadmap did not require U.S. card issuers to enable PINs – or any other multi-layer security – on EMV chip cards despite significant evidence worldwide that chip-and-PIN helps reduce fraud rates.[19]

There remains a tendency by banks and credit unions to steer consumers toward debit transactions that generate the highest fees rather than the lowest cost and lowest fraud. According to the November 2016 Fed report, PIN debit transactions are less costly for issuers to conduct than signature debit transactions (2.4 cents for single-message [i.e. PIN] vs. 4.8 cents for signature)[20] and PIN debit fraud is lower than signature debit fraud - the Fed reported that there was $2.41 billion in debit fraud in 2015 (a total that includes fraud losses that are borne by merchants and consumers as well as banks) but just a fraction of that fraud ($0.38 billion) was associated with PIN debit transactions.[21] However, small banks and credit unions appear to prefer signature debit over PIN despite the lower cost and lower fraud associated with PIN - out of 21.23 billion debit transactions for small banks

[16] *See, e.g.*, American Banker, "Counterintuitive Pitch for Higher-Fee Debit Category" April 21, 2010, (discussing JP Morgan Chase's efforts to urge cardholders to stop using PINs), at https://www.americanbanker.com/news/counterintuitive-pitch-for-higher-fee-debit-category.

[17] *See* letter from Senator Durbin to Jaime Dimon, Chairman and CEO, JP Morgan Chase & Co., April 12, 2011, at 3, *available at* http://www.durbin.senate.gov/newsroom/press-releases/letter-to-jpmorgan-chase-ceo-jamie-dimon-regarding-interchange-fees (noting that Chase urged its U.S. customers to "always select" signature debit whereas in Canada, where debit interchange fees are not charged, Chase's subsidiary promoted secure chip and PIN technology.).

[18] *See* Visa presentation to Federal Reserve on U.S. Debit EMV, January 8, 2014, at 2, *available at* http://www.federalreserve.gov/newsevents/rr-commpublic/visa-meeting-20140108.pdf ("In August 2011, Visa announced a U.S. EMV roadmap.").

[19] *See* Douglas King, "Chip-and-PIN: Success and Challenges in Reducing Fraud," Retail Payments Risk Forum Working Paper, Federal Reserve Bank of Atlanta, Jan. 2012, *available at* https://www.frbatlanta.org/-/media/Documents/rprf/rprf_pubs/120111wp.pdf.

[20] Board of Governors of the Federal Reserve System, "2015 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions", at p. 23, available at https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2015.pdf.

[21] *Id.*, at p. 19.

and credit unions in 2015, only 6.9 billion were PIN.[22] Why? Perhaps because for small banks and credit unions, debit interchange fee rates are far higher for signature transactions than PIN transactions. Issuers with assets of under $10 billion received an average of 51 cents per signature debit transaction and 26 cents per PIN transaction in 2015.[23]

**Myth #12:** **The Durbin Amendment forced Visa and MasterCard to increase swipe fees on small dollar transactions.**

**Reality:** **For years Visa and MasterCard have increased fees and created new fees whenever market and regulatory conditions enabled them to get away with it, and they continue to do so. Make no mistake- the card networks and banking industry are not fighting to repeal the Durbin Amendment so that they can reduce fees. Repeal would mean higher fees, plain and simple.**

Visa and MasterCard were increasing fees for years prior to the Durbin Amendment, and they continue to use their market dominance to increase fees on merchants whenever they are able. The solution to that problem is not repeal of the 2010 law but rather further reform to rein in Visa's and MasterCard's unreasonable fees, either by enabling more competition or by placing stricter limits on their fee-fixing.

The banking industry claims that the Durbin Amendment caused debit swipe fee rates to increase for small businesses because it forced card networks to abandon "discounted" debit swipe rates for small dollar transactions. This claim has no basis in evidence. Before 2010, networks typically fixed swipe fee rates that were an *ad valorem* fee plus a flat fee (*e.g.*, 1.2% plus 5 cents). This fee structure meant fees grew bigger as the transaction size increased, but there is no evidence that the networks were setting small dollar transaction rates that were discounted below the transaction cost incurred by large issuers with over $10 billion in assets (which the Fed most recently pegged at about 4 cents). Rather, Visa and MasterCard set fee rates that provided card-issuing banks with profit margins that exceeded what a competitive market could sustain on transactions of all sizes.

Visa and MasterCard did increase their swipe fee rates on certain small dollar transactions after the Durbin Amendment took effect. But that is not the fault of the Durbin Amendment; rather, this was the result of a concerted lobbying campaign by the banks and the card networks to weaken the Fed's rule, followed quickly by Visa and MasterCard's decisions to triple their small-dollar swipe fee rates on some transactions. When the 2010 law imposed a reasonableness requirement on price-fixed swipe fees, big banks and card networks fiercely lobbied the Federal Reserve for an implementing rule that set a maximum fee rate far higher than the transaction costs the Fed had identified. The Fed bowed to this lobbying campaign and issued a final rule with a price-fixing limitation that

[22] *Id.*, at Table 3 on p. 31.

[23] *Id.*, at Table 5 on p. 32. Note that the difference between PIN and signature average interchange fees for exempt issuers is likely attributable to the fact that there about a dozen networks competing in the PIN debit market and this competition drives down fee levels, whereas the Visa/MasterCard duopoly are the only signature debit networks and the lack of competition keeps fees high.

allowed banks to charge as much as 22-24 cents- far higher than the actual cost to a big bank of conducting a debit transaction, which is just a few cents.

After the Fed issued its final rule, first MasterCard and then Visa promptly raised their small dollar swipe rates to the maximum price-fixed fee allowable, doubling the fees previously charged on some transactions even though nothing changed with respect to the cost of the transactions. MasterCard and Visa were not forced by the Durbin Amendment to increase those swipe rates- they did so because they focus more on winning the business of issuing banks than serving merchants and consumers, and because they have the market power to get away with dramatic price-fixed fee increases (except where they are reined in by effective regulation).

If banks and card companies were truly concerned about these small dollar swipe fee rate increases, they could reduce them at any time. Instead, banks and card companies fought in court against efforts to compel the Fed to revise its rule to reverse these small ticket swipe fee increases. The banks and card networks won't reduce their fees on small dollar transactions because this was an outcome they wanted and lobbied for during the rule-writing process.

**Myth #13: Merchants have not passed along savings from swipe fee reform to consumers.**

**Reality: Savings from swipe fee reform are passed along to consumers through price competition among retailers, and the retail sector (unlike the debit card industry) is intensely competitive.**

Financial industry lobbyists' claims reflect a lack of understanding about competitive markets. Cost savings are passed along from merchants to consumers to the extent that the merchant marketplace is price-competitive. Most merchant sectors are very price competitive, particularly the markets for goods that consumers rely upon the most such as gas and groceries. Overall the retail industry has about 2 percent net profit margins, far less than large banks which enjoy about 24 percent net profit margins and Visa and MasterCard whose net profit margins are around 40 percent.[24]

While it is difficult to measure consumer savings from swipe fee reform on a product-by-product basis,[25] the aggregate savings for consumers are significant and should be preserved. Noted economist Robert Shapiro has crunched the aggregate numbers and concluded that in 2012, swipe fee reform saved consumers

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[24] *See* http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html, http://financials.morningstar.com/ratios/r.html?t=V&region=usa&culture=en-US and http://financials.morningstar.com/ratios/r.html?t=MA&region=USA&culture=en_US.

[25] *See* Fumiko Hayashi, "The New Debit Card Regulations: Effects on Merchants, Consumers, and Payments System Efficiency, " First Quarter 2013, at 102, *available at* https://www.kansascityfed.org/publicat/econrev/pdf/13q1Hayashi.pdf (noting that with interchange reform "[t]he pass through of cost savings from merchants to consumers is not easy to measure, even when merchants pass on all their savings to consumers.").

nearly $6 billion across the economy and supported over 37,000 new jobs.[26] And when banks and card networks bemoan that consumers have not saved enough from swipe fee reform, they never mention that they aggressively lobbied the Fed during the rulemaking process to reduce the amount of savings consumers could achieve.

**Myth #14: There is no further need for regulation of the swipe fee system at all.**

**Reality: Visa and MasterCard continue to use anticompetitive practices to dominate the market for electronic payments. This shows the need for continued vigilance and regulatory oversight including the Durbin Amendment.**

Visa and MasterCard are still up to their old tricks. For example, on November 22, 2016 Visa agreed to change its network rules in response to an FTC investigation into whether Visa was violating the Durbin Amendment's nonexclusivity/routing provisions by steering consumers away from PIN debit network competitors. Visa had been pushing its vendors to install misleading touch-screens at point-of-sale card readers that prompted cardholders to choose between "Visa Debit" and "U.S. Debit." According to the FTC, "Visa's existing rules told merchants to present a selection screen to customers paying with a debit card. This screen asked customers to select which application would process their transaction, but only one of these applications permitted merchants to access every competing payment card network enabled on the card."[27] Also, in 2016 both Visa and MasterCard sought to introduce new fees to penalize small banks and credit unions for doing business with other card networks.[28] And, in an embarrassment to Visa and MasterCard, the Supreme Court on November 17, 2016 dismissed a case the Court had taken up that June involving allegations by consumers and ATM operators that Visa and MasterCard illegally coordinated with big banks to adopt anticompetitive ATM fees. Visa and MasterCard wanted the Court to overturn a lower court ruling that said the antitrust case could move forward, but the Court dismissed the case after Visa and MasterCard tried to change their legal arguments mid-stream.[29]

Senator Durbin has pointed out in this op-ed that the current campaign by the financial industry to repeal the 2010 swipe fee reform actually appears to be an effort to distract Congress from new schemes that the banks and card networks are setting up to rig the credit and debit card systems in their favor. Congress must not get distracted.

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[26] *See* Robert J. Shapiro, "The Costs and Benefits of Half a Loaf: The Economic Effects of Recent Regulation of Debit Card Interchange Fees," Oct. 1, 2013, *available at* http://www.sonecon.com/docs/studies/Report_on_Interchange_Fees-RShapiro-October_2013.pdf

[27] *See* Jim Daly, "Visa Modifies Its Controversial EMV Debit Card Transaction-Routing Policies," Digital Transactions News, Nov. 22, 2016, *available at* http://www.digitaltransactions.net/news/story/Visa-Modifies-Its-Controversial-EMV-Debit-Card-Transaction-Routing-Policies.

[28] *See id.* and Jennifer Surane, "Visa, MasterCard Scolded by Durbin on 'Bad-for-Competition' Fees," Bloomberg, June 6, 2016, *available at* https://www.bloomberg.com/news/articles/2016-06-10/visa-mastercard-scolded-by-durbin-on-bad-for-competition-fees.

[29] *See* Associated Press, "High Court Dismisses Case over High ATM Fees," Nov. 17, 2016, *available at* http://bigstory.ap.org/article/1fabd39361d840c3a3a27b04c6b6efe9/high-court-dismisses-case-over-high-atm-fees.

## Summary of the Durbin Amendment

- The amendment contains two main parts.  The first part directed the Federal Reserve Board to place reasonable constraints on the debit interchange price-fixing that big card-issuing banks permit networks like Visa to perform on their behalf.  The second part rescinded several anti-competitive restrictions that card networks had imposed on other participants in the debit system.

- Part 1: Requires the Fed to ensure that for transactions involving debit cards issued by banks with assets over $10 billion, any interchange fee set by a card network on behalf of its issuing banks must be reasonable and proportional to the cost the issuer incurred for the transaction.
    - Directs the Fed to allow for an interchange fee adjustment to cover an issuing bank's fraud prevention costs if the bank is successful in preventing fraud.
    - Exempts small banks and credit unions from interchange fee regulation.
    - Exempts any covered issuer that negotiates interchange fees in the free market instead of adopting Visa and MasterCard's price-fixed rates.
    - Exempts government-administered debit cards and reloadable prepaid debit cards from interchange regulation so long as abusive cardholder fees are not charged (overdraft fees and fees for first monthly ATM withdrawal).

- Part 2: Stops card networks from engaging in certain anti-competitive practices.
    - Prevents networks from penalizing merchants who offer discounts for use of cash, check or debit as a method of payment.
    - Prevents networks from penalizing merchants who set a $10 credit card minimum.
    - Prevents networks from penalizing universities and government agencies who set a maximum limit on credit card transactions.
    - Directs the Fed to issue rules ensuring that banks and card networks cannot limit a debit card to only be allowed to be run exclusively on one network.  (These exclusivity agreements, which had grown to cover 40-50% of all debit cards, were forcing smaller debit networks out of business.)

## Summary of the Federal Reserve's Implementing Regulations

- In June 2011, the Fed issued final rules providing that debit interchange fees fixed by card networks on behalf of big banks cannot be greater than 21 cents plus 0.05% of the transaction amount.  The Fed also permitted big banks to receive an extra 1 cent per transaction if the bank has adopted fraud prevention policies and procedures.  Under the Fed's final rule, the average big bank debit interchange fee is now about 24 cents (down from a pre-2011 average of 44 cents, but still far higher than the actual cost of debit transactions for big bank issuers which is just a few cents).  This fee regulation took effect in October 2011.

- The Fed's final rulemaking also required card-issuing banks to enable debit cards with at least two unaffiliated networks and to allow merchants to choose which of these networks to route debit transactions over.